6

Amalgamation

Learning Objectives
After studying this chapter, you will be able to ♦ Understand the term “Amalgamation” and the methods of accounting for amalgamations. ♦ Appreciate the concept of transferee Company and the transferor company. ♦ Calculate purchase consideration under both the methods of amalgamation as per AS 14. ♦ Pass the entries to close the books of the vendor company. ♦ Pass the journal entries in the books of purchasing company to incorporate the assets and liabilities of the vendor company and also giving effect to other adjustments.

1. Meaning of Amalgamation

In an amalgamation, two or more companies are combined into one by merger or by one taking over the other. Therefore, the term ‘amalgamation’ contemplates two kinds of activities:

(*i*) two or more companies join to form a new company or

(*ii*) absorption and blending of one by the other.

Thus, amalgamations include absorption.

The purpose of companies joining together is to secure various advantages such as economies of large scale production, avoiding competition, increasing efficiency, expansion etc.

The companies going into liquidation or merged companies are called vendor companies or transferor companies. The new company which is formed to take over the liquidated companies or the company with which the transferor company is merged is called transferee or vendee.

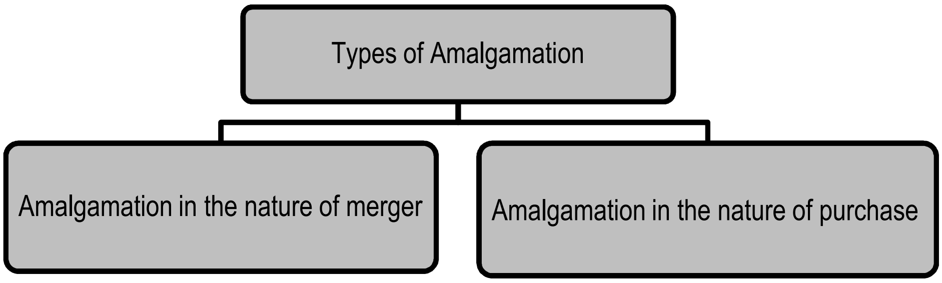
In the case of amalgamation the assets and liabilities of transferor company(s) are amalgamated and the transferee company becomes vested with all such assets and liabilities.

Wherever an undertaking is being carried on by a company and is in substance transferred, not to an outsider, but to another company consisting substantially of the same shareholders with a view to its being continued by the transferee company, there is external reconstruction. Such external reconstruction is essentially covered under the category 'amalgamation in the nature of merger' in AS 14.

Basis	Amalgamation	Absorption	External Reconstruction
Meaning	Two or more companies are wound up and **a new company** is formed to take over their business.	In this case **an existing company** takes over the business of **one or more** existing companies.	In this case, **a newly formed company** takes over the business of an **existing company**.
Minimum number of Companies involved	Atleast three companies are involved.	Atleast two companies are involved.	Only two companies are involved.
Number of new resultant companies	Only one resultant company is formed. Two companies are wound up to form a **single** resultant company.	**No** new resultant company is formed.	Only one resultant company is formed. Under this case **a newly formed company** takes over the business of an existing company.
Objective	Amalgamation is done to cut competition & reap the economies in large scale.	Absorption is done to cut competition & reap the economies in large scale.	External reconstruction is done to reorganise the financial structure of the company.
Example	A Ltd. and B Ltd. amalgamate to form C Ltd.	A Ltd. takes over the business of another existing company B Ltd.	B Ltd. is formed to take over the business of an existing company A Ltd.

2. Types of Amalgamation

The Institute of Chartered Accountants of India has introduced Accounting Standard -14 (AS 14) on 'Accounting for Amalgamations'. The standard recognizes two types of amalgamation –



Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(*i*) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(*ii*) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(*iii*) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(*iv*) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(*v*) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

If any one or more of the above conditions are not satisfied in an amalgamation, such amalgamation is called ***amalgamation in the nature of purchase***.

3. Purchase Consideration

For the purpose of accounting for amalgamations, we are essentially guided by AS-14 'Accounting for Amalgamations'. Para 3(g) of AS 14 defines the term purchase consideration as the "*aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company*". In simple words, it is the price payable by the transferee company to the transferor company for taking over the business of the transferor company.

It is notable that purchase consideration ***does not include*** the sum which the transferee company will directly pay to the creditors of the transferor company.

The purchase consideration essentially depends upon the fair value of its elements. For example, when the consideration includes securities, the value fixed by the statutory authority may be taken as the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up or in the absence of market value, book value of the assets are considered.

Sometimes adjustments may have to be made in the purchase consideration in the light of one or more future events. When the additional payment is probable and can be reasonably estimated it is to be included in the calculation of purchase consideration.

Illustration 1

Let us consider the draft Balance Sheet of X Ltd. as on 31st March, 2014:

Liabilities	*₹ ('000)*	*Assets*	*₹ ('000)*
Share Capital:		*Land & Buildings*	*50,00*
Equity Shares of ₹ 10 each	*75,00*	*Plant & Machinery*	*45,00*
14% Preference Shares of		*Furniture*	*10,50*
₹ 100 each	*25,00*	*Investments*	*5,00*
General Reserve	*12,50*	*Inventory*	*23,00*
12% Debentures	*40,00*	*Trade receivables*	*24,00*
Trade payables and other		*Cash & Bank balance*	*15,00*
Current liabilities	*20,00*		
	172,50		*172,50*

Other Information:

(i) Y Ltd. takes over X Ltd. on 10th April, 2014.

(ii) Debentureholders of X Ltd. are discharged by Y Ltd. at 10% premium by issuing 15% own debentures of Y Ltd.

(iii) 14% Preference Shareholders of X Ltd. are discharged at a premium of 20% by issuing necessary number of 15% Preference Shares of Y Ltd. (Face value ₹ 100 each).

(iv) Intrinsic value per share of X Ltd. is ₹ 20 and that of Y Ltd. ₹ 30. Y Ltd. will issue equity shares to satisfy the equity shareholders of X Ltd. on the basis of intrinsic value. However, the entry should be made at par value only. The nominal value of each equity share of Y Ltd. is ₹ 10.

Compute the purchase consideration.

Solution

Computation of Purchase consideration	*(₹ in '000)*	*Form*
For Preference Shareholders of X Ltd.	3,000	30,000 15% Preference

		shares in Y Ltd.
For equity shareholders of X Ltd.	5,000	5,00,000 Equity
(2/3 × 7,50,000) × ₹ 10		shares of Y Ltd.
of ₹ 10 each		
Total Purchase consideration	8,000	

Note : Consideration for debenture holders should not be included above. Such debentures will be taken over by Y Ltd. and then discharged.

Illustration 2

Neel Ltd. and Gagan Ltd. amalgamated to form a new company on 1.04.2015. Following is the Draft Balance Sheet of Neel Ltd. and Gagan Ltd. as at 31.3.2015:

Liabilities	*Neel*	*Gagan*	*Assets*	*Neel*	*Gagan*
	₹	*₹*		*₹*	*₹*
Capital	*7,75,000*	*8,55,000*	*Plant & Machinery*	*4,85,000*	*6,14,000*
Current liabilities	*6,23,500*	*5,57,600*	*Building*	*7,50,000*	*6,40,000*
			Current assets	*1,63,500*	*1,58,600*
	13,98,500	*14,12,600*		*13,98,500*	*14,12,600*

Following are the additional information:

(i) The authorised capital of the new company will be ₹ 25,00,000 divided into 1,00,000 equity shares of ₹ 25 each.

(ii) Liabilities of Neel Ltd. includes ₹ 50,000 due to Gagan Ltd. for the purchases made. Gagan Ltd. made a profit of 20% on sale to Neel Ltd.

(iii) Neel Ltd. had purchased goods costing ₹ 10,000 from Gagan Ltd. All these goods are included in the current asset of Neel Ltd. as at 31st March, 2015.

(iv) The assets of Neel Ltd. and Gagan Ltd. are to be revalued as under:

	Neel	*Gagan*
	₹	*₹*
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

(v) The purchase consideration is to be discharged as under:

(a) Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years.

(b) Profits for the preceding 2 years are given below:

	Neel	*Gagan*
	₹	₹
1st year	2,62,800	2,75,125
IInd year	2,12,200	2,49,875
Total	4,75,000	5,25,000

(c) Issue 12% preference shares of ₹ 10 each fully paid up at par to provide income equivalent to 8% return on net assets in the business as on 31.3.2015 after revaluation of assets of Neel Ltd. and Gagan Ltd. respectively.

You are required to compute the

(i) equity and preference shares issued to Neel Ltd. and Gagan Ltd.,

(ii) Purchase consideration.

Solution

(i) Calculation of equity shares to be issued to Neel Ltd. and Gagan Ltd.

Profits of	*Neel*	*Gagan*
	₹	₹
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability

	Neel	*Gagan*
24,000 x 475/1000	11,400 equity shares	
24,000 x 525/1000		12,600 equity shares

Calculation of 12% Preference shares to be issued to Neel Ltd. and Gagan Ltd.

	Neel	*Gagan*
	₹	₹
Net assets (Refer working note)	8,40,000	9,24,000
8% return on Net assets	67,200	73,920
12% Preference shares to be issued	56,000 shares	
$\left[67{,}200 \times \frac{100}{12}\right] = 5{,}60{,}000 @ ₹ 10 \text{ each}$		

$\left[73{,}920 \times \frac{100}{12}\right] = 6{,}16{,}000\ @\ ₹\ 10\ \text{each}$		61,600 shares

(ii) Total Purchase Consideration

	Neel	*Gagan*
	₹	₹
Equity shares @ of ₹ 25 each	2,85,000	3,15,000
12% Preference shares @ of ₹ 10 each	5,60,000	6,16,000
Total	8,45,000	9,31,000

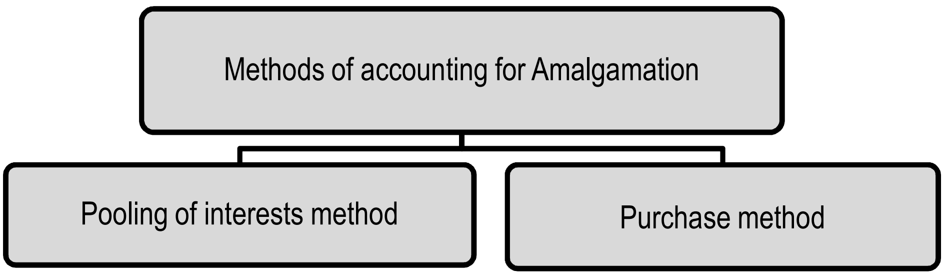
Working Note:

Calculation of Net assets as on 31.3.2015

	Neel	*Gagan*
	₹	₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
Less: Current liabilities	(6,23,500)	(5,57,600)
	8,40,000	9,24,000

4. Methods of Accounting for Amalgamations

There are two main methods of accounting for amalgamation viz,



The *first method is used in* case of *amalgamation in the nature of merger* and the *second method* is used in case of *amalgamation in the nature of purchase*.

Pooling of Interest Method

Under pooling of interests method, the assets, liabilities and reserves of the Transferor Company will be taken over by Transferee Company at existing carrying amounts unless any

adjustment is required due to different accounting policies followed by these companies. As a result the difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of Transferor Company should be adjusted in reserves.

Purchase Method

Assets and Liabilities: the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

Reserves: No reserves, other than statutory reserves, of the transferor company should be incorporated in the financial statements of transferee company. Statutory reserves of the transferor company should be incorporated in the balance sheet of transferee company by way of the following journal entry.

Amalgamation Adjustment A/c Dr.

To Statutory Reserves

When the above statutory reserves will no longer be required to be maintained by transferee company, such reserves will be eliminated by reversing the above entry.

The balance of Profit and Loss account of the transferor company is not recorded at all.

Difference between the Purchase Consideration and Net Assets transferred: Any excess of the amount of purchase consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised as goodwill in the financial statement of the transferee company. Any short fall should be shown as capital reserve. Goodwill should be amortised over period of five years unless a somewhat longer period can be justified.

Illustration 3

Consider the following summarized balance sheets of X Ltd. and Y Ltd.

Balance Sheet as on 31st March, 2015

Liabilities	*X Ltd.*	*Y Ltd.*	*Assets*	*X Ltd.*	*Y Ltd.*
	₹ '000	*₹ '000*		*₹ '000*	*₹ '000*
Equity Share Capital	*50,00*	*30,00*	*Land & Building*	*25,00*	*15,50*
(₹ 10 each)			*Plant & Machinery*	*32,50*	*17,00*
14% Preference Share	*22,00*	*17,00*	*Furniture & Fittings*	*5,75*	*3,50*
Capital (₹ 100 each)			*Investments*	*7,00*	*5,00*
General Reserve	*5,00*	*2,50*	*Inventory*	*12,50*	*9,50*
Export Profit Reserve	*3,00*	*2,00*	*Trade receivables*	*9,00*	*10,30*

Investment Allowance Reserve		*1,00*	*Cash & Bank*	*7,25*	*5,20*
Profit & Loss A/c	*7,50*	*5,00*			
13% Debentures (₹ 100 each)	*5,00*	*3,50*			
Trade payables	*4,50*	*3,50*			
Other Current Liabilities	*2,00*	*1,50*			
	99,00	*66,00*		*99,00*	*66,00*

X Ltd. takes over Y Ltd. on 1st April, 2015. X Ltd. discharges the purchase consideration as below:

(i) Issued 3,50,000 equity shares of ₹ 10 each at par to the equity shareholders of Y Ltd.

(ii) Issued 15% preference shares of ₹ 100 each to discharge the preference shareholders of Y Ltd. at 10% premium.

The debentures of Y Ltd. will be converted into equivalent number of debentures of X Ltd. The statutory reserves of Y Ltd. are to be maintained for 2 more years.

Show the balance sheet of X Ltd. after amalgamation on the assumption that:

(a) the amalgamation is in the nature of merger.

(b) the amalgamation is in the nature of purchase.

Solution:

(a) Amalgamation in the nature of merger:

Balance Sheet of X Ltd.

		Particulars	*Notes*	*₹ in '000*
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570
	b	Reserves and Surplus	2	1,930
2		**Non-current liabilities**		
	a	Long-term borrowings	3	850
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		**16,500**

		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	4	9,925
	b	Non-current investments		1,200
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and cash equivalents		1,245
		Total		**16,500**

Notes to accounts

				₹ in '000
1	**Share Capital**			
	Equity share capital			
	85,00, Equity Shares of ₹ 10 each			8,500
	Preference share capital			
	18,700, 15% Preference Shares of ₹ 100 each			1,870
	22,000, 14% Preference Shares of ₹ 100 each			2,200
	Total			**12,570**
2	**Reserves and Surplus**			
	General Reserve of X Ltd.	500		
	Add: General reserve of Y Ltd.	250	750	
	Less: Adjustment for amalgamation*		(670)	80
	Export Profit Reserve of X Ltd.		300	
	Add: Export Profit Reserve of Y Ltd.		200	500
	Investment Allowance Reserve			100
	Profit & Loss A/c of X Ltd.		750	
	Add: Profit & Loss A/c of Y Ltd.		500	1,250
	Total			**1,930**
3	**Long-term borrowings**			
	Secured			

	8,500 13% Debentures of ₹ 100 each		850
	Total		**850**
4	**Tangible assets**		
	Land & Buildings		4,050
	Plant & Machinery		4,950
	Furniture & Fittings		925
	Total		**9,925**

*The difference between the amount recorded as share capital issued and the amount of share capital of transferor company should be adjusted in reserves. Thus,

Adjustment for amalgamation = ₹ '000 (53,70 – 47,00) = ₹ ('000) 670

(b) Amalgamation in the nature of purchase :

Balance Sheet of X Ltd.

		Particulars	*Notes*	*₹ in'000*
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	12,570
	b	Reserves and Surplus	2	2,230
2		**Non-current liabilities**		
	a	Long-term borrowings	3	850
3		**Current liabilities**		
	a	Trade Payables		800
	b	Other current liabilities		350
		Total		**16,800**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	4	9,925
	b	Non-current investments		1,200
	c	Other non-current assets	5	300
2		**Current assets**		
	a	Inventories		2,200
	b	Trade receivables		1,930
	c	Cash and cash equivalents		1,245
		Total		**16,800**

Notes to accounts

			₹ in'000
1	**Share Capital**		
	Equity share capital		
	85,00, Equity Shares of ₹ 10 each		8,500
	Preference share capital		
	18,700, 15% Preference Shares of ₹ 100 each		1,870
	22,000, 14% Preference Shares of ₹ 100 each		2,200
	Total		**12,570**
2	**Reserves and Surplus**		
	Capital Reserve		380
	General Reserve		500
	Export Profit Reserve		500
	Investment Allowance Reserve		100
	Surplus (Profit & Loss A/c)		750
	Total		**2,230**
3	**Long-term borrowings**		
	Secured		
	8,500 13% Debentures of ₹ 100 each		850
	Total		**850**
4	**Tangible assets**		
	Land & Buildings		4,050
	Plant & Machinery		4,950
	Furniture & Fittings		925
	Total		**9,925**
5.	**Other non-current asset**		
	Amalgamation adjustment account (assumed to be maintained for more than a year)		300

Workings: Capital Reserve arising on Amalgamation:

(A)	Net Assets taken over:	₹ ('000)	₹ ('000)
	Sundry Assets		66,00
	Less : 13% Debentures	3,50	
	Trade payables	3,50	

	Other current liabilities	1,50	(8,50)
			57,50
(B)	Purchase consideration :		
	To Equity Shareholders of Y Ltd.		35,00
	To Preference Shareholders of Y Ltd.		18,70
			53,70
(C)	Capital Reserve (A – B)		3,80

Illustration 4

S. Ltd. is absorbed by P. Ltd. The draft balance sheet of S. Ltd. is as under:

Balance Sheet

	₹		₹
Share Capital :			
2,000 7% Preference shares		*Sundry Assets*	*13,00,000*
of ₹ 100 each (fully paid-up)	*2,00,000*		
5,000 Equity shares of ₹ 100			
each (fully paid-up)	*5,00,000*		
Reserves	*3,00,000*		
6% Debentures	*2,00,000*		
Trade payables	*1,00,000*		
	13,00,000		*13,00,000*

P. Ltd. has agreed :

(i) to issue 9% Preference shares of ₹ 100 each, in the ratio of 3 shares of P. Ltd. for 4 preference shares in S. Ltd.

(ii) to issue to the debenture-holders in S. Ltd. 8% Mortgage Debentures at ₹ 96 in lieu of 6% Debentures in S. Ltd. which are to be redeemed at a premium of 20%;

(iii) to pay ₹ 20 per share in cash and to issue six equity shares of ₹ 100 each (market value ₹ 125) in lieu of every five shares held in S. Ltd.; and

(iv) to assume the liability to trade payables.

You are required to calculate the purchase consideration.

Solution

The purchase consideration will be

	₹	*Form*
Preference shareholders : 2,000 × 3/4 × 100	1,50,000	9% Pref. shares

Equity shareholders :	5,000 × 20	1,00,000	Cash
	5,000 × 6/5 × 125	7,50,000	Equity shares
		10,00,000	

According to AS 14, 'consideration' for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company. Therefore, debentures issued to the debenture holders will not be included in purchase consideration. Like trade payables, the liability in respect of debentures of S. Ltd. will be taken by P Ltd., which will then be settled by issuing new 8% debentures.

Illustration 5

Y Ltd. decides to absorb X Ltd. The draft Balance Sheet of X Ltd. is as follows:

	₹		₹
3,000 Equity shares of		*Net assets*	*2,90,000*
₹ 100 each (fully paid)	*3,00,000*	*Profit and Loss Account*	*70,000*
Preference shares	*60,000*		
	3,60,000		*3,60,000*

Y Ltd. agrees to take over the net assets of X Ltd. An equity share in X Ltd., for purposes of absorption, is valued @ ₹ 70. Y Ltd. agrees to pay ₹ 60,000 in cash for payment to preference shareholders equity shares will be issued at value of ₹ 120 each. Calculate purchase consideration to be paid by Y Ltd. and how will it be discharged?

Solution

Value of 3,000 shares of X Ltd. @ ₹ 70 = ₹ 2,10,000

The purchase consideration will be:

= ₹ 2,10,000 for equity shares + ₹ 60,000 for Liability towards preference shareholders

= ₹ 2,70,000

₹ 60,000 out of the above will be in cash and ₹ 2,10,000 in the form of equity shares of Y Ltd., issued at ₹ 120 per share; the number of shares that will be issued = 2,10,000/120 = 1,750 equity shares.

5. Journal Entries to close the books of Vendor Company

The journal entries will be illustrated with the following case.

Wye Ltd. acquires the business of Zed Ltd. whose summarised balance sheet on 31st December, 2014 is as under :

Liabilities	*₹*	*Assets*	*₹*
Share capital divided into		*Goodwill*	*2,00,000*
shares of ₹ 100 each		*Land & Buildings*	*4,00,000*
6% Preference share capital	*4,00,000*	*Plant and Machinery*	*6,00,000*
Equity share capital	*8,00,000*	*Patents*	*50,000*
Capital Reserve	*1,00,000*	*Inventory*	*1,50,000*
Profit & Loss A/c	*50,000*	*Trade receivables*	*1,80,000*
6% Debentures	*2,00,000*	*Cash at bank*	*70,000*
Interest outstanding on above	*12,000*	*Underwriting commission*	*40,000*
Workmen's compensation reserve			
(Expected liability ₹ 5,000)	*8,000*		
Trade payables	*1,20,000*		
	16,90,000		*16,90,000*

Wye Ltd. was to take over all assets (except cash) and liabilities (except for interest due on debentures) and to pay following amounts:

(i) ₹ 2,00,000 7% Debentures (₹ 100 each) in Wye Ltd. for the existing debentures in Zed Ltd.; for the purpose, each debenture of Wye Ltd. is to be treated as worth ₹ 105.

(ii) For each preference share in Zed Ltd. ₹ 10 in cash and one 9% preference share of ₹ 100 each in Wye Ltd.

(iii) For each equity share in Zed Ltd. ₹ 20 in cash and one equity share in Wye Ltd. of ₹ 100 each having the market value of ₹ 140.

(iv) Expense of liquidation of Zed Ltd. are to be reimbursed by Wye Ltd. to the extent of ₹ 10,000. Actual expenses amounted to ₹ 12,500.

Wye Ltd. valued Land and building at ₹ 5,50,000 Plant and Machinery at ₹ 6,50,000 and patents at ₹ 20,000.

Purchase Consideration:

			₹	*Form*
(*i*)	Preference Shares: ₹ 10 per share	40,000		Cash
	Preference shares	4,00,000	4,40,000	Preference shares
(*ii*)	Equity shares: ₹ 20 per share	1,60,000		Cash
	8,000 equity shares in			
	Wye Ltd. @ ₹ 140	11,20,000	12,80,000	Equity shares
			17,20,000	

Steps to close the Books of the Vendor Company

1. Open Realisation Account and transfer all assets at book value.

Exception: If cash is not taken over by the purchasing company, it should not be transferred.

Note: Profit and Loss Account (Dr.) and expenses not written off are not assets and should not be transferred to the Realisation Account.

The journal entry in the above case is:		₹	₹
Realisation A/c	Dr.	15,80,000	
To Sundries —			
Goodwill			2,00,000
Land & Building			4,00,000
Plant & Machinery			6,00,000
Patents			50,000
Inventory			1,50,000
Trade receivables			1,80,000
(Transfer of assets to Realisation Account on sale of business to Wye Ltd.)			

2. Transfer to the Realisation Account the liabilities which the purchasing company is to take over. In case of the provisions, the portion which represents liability expected to arise in future should be so transferred and the portion which is not required (*i.e.,* the reserve portion) should be treated as profit. Accordingly, the following entry will be recorded:

		₹	₹
6% Debentures in Wye Ltd.	Dr.	2,00,000	
Workmen's Compensation Reserve	Dr.	5,000	
Trade payables	Dr.	1,20,000	
To Realisation A/c			3,25,000
(Transfer of liabilities taken over by Wye Ltd. to Realisation A/c)			

For liabilities not take over by the purchasing company, the profit or loss on discharge of such liabilities shall be transferred to Realisation Account.

3. Debit purchasing company and credit Realisation Account with the purchase consideration.

Wye Ltd.-	Dr.	17,20,000	

To Realisation A/c			17,20,000
(Amount receivable from Wye Ltd. for sale of business)			

4. On receipt of the purchase consideration debit what is received (cash, debentures, shares etc.) and credit the purchasing company. Thus —

Cash	Dr.	2,00,000	
9% Preference shares in Wye Ltd.	Dr.	4,00,000	
Equity shares in Wye Ltd.	Dr.	11,20,000	
To Wye Ltd.			17,20,000
(Receipt of purchase consideration from the purchase company)			

5. Expenses of liquidation have to be dealt with according to the circumstances of each case.
   - (a) If the vendor company has to bear and pay them:
     Realisation Account should be debited and Cash Account credited.
   - (b) If the expenses are to be borne by the purchasing company, the question may be dealt within one of the two ways mentioned below:
     - (*i*) It may be ignored in the books of the vendor company.
     - (*ii*) If the expenses are to be paid first by the vendor company and afterwards reimbursed by the purchasing company, the following two entries will be passed :
       - (*a*) Debit Purchasing company and credit Cash Account when expenses are paid by the vendor company; and
       - (*b*) Debit Cash Account and credit purchasing company (on the expenses being reimbursed).

   In the above mentioned case Wye Ltd. has to pay maximum of ₹ 10,000 only whereas, the amount spent is ₹ 12,500. Hence ₹ 2,500 is to be borne by Zed Ltd.; the entries required will be :

		₹	₹
Wye Ltd.	Dr.	10,000	
Realisation A/c	Dr.	2,500	
To Cash A/c			12,500
(Liquidation expenses out of which ₹ 10,000 is payable by Wye Ltd.)			
Cash A/c	Dr.	10,000	
To Wye Ltd.			10,000
(Account reimbursed by Wye Ltd. for expense)			

6. Liabilities not assumed by the purchasing company, have to be paid off. On payment, debit the liability concerned and credit cash. Any difference between the amount actually paid and the book figure must be transferred to the Realisation Account. Zed Ltd. shall pass the following entries in this respect :

		₹	₹
Interest Outstanding	Dr.	12,000	
To Debentureholders A/c			12,000
(Amount due to debenture holders for debentures interest)			
Debentureholders	Dr.	12,000	
To Cash A/c			12,000
(Debentureholders paid cash ₹ 12,000 for outstanding interest)			

7. Credit the preference shareholders with the amount payable to them, debiting Preference Share Capital with the amount shown in the books, transferring the difference between the two, if any, to the Realisation Account. Thus —

6% Pref. Share Capital A/c	Dr.	4,00,000	
Realisation A/c	Dr.	40,000	
To Preference Shareholders A/c			4,40,000
(The amount due to preference shareholders for capital and the extra amount payable under the scheme of absorption)			

Note : In the absence of any indication to the contrary, preference shareholders will be entitled only to the capital contributed by them. But if funds available after paying off creditors are not sufficient to satisfy the claim of preference shareholders fully, they will have to suffer a loss to the extent of the deficit.

8. Pay off preference shareholders by debiting them and crediting whatever is given to them. The entry in the above case is :

		₹	₹
Preference shareholders A/c	Dr.	4,40,000	
To Cash A/c			40,000
To 9% Preference shares in Wye Ltd.			4,00,000
(Cash and preference shares in Wye Ltd. given to preference shareholders)			

9. Transfer equity share capital and account representing profit or loss (including the balance in Realisation Account) to Equity Shareholders Account. This will determine the amount receivable by the equity shareholders. Zed Ltd. shall pass the following entries in this regard :

		₹	₹
Equity Share Capital A/c	Dr.	8,00,000	
Capital Reserve A/c	Dr.	1,00,000	
Profit and Loss A/c	Dr.	50,000	
Workmen's Compensation Reserve A/c	Dr.	3,000	
Realisation A/c	Dr.	4,22,500*	
To Sundry Equity Shareholders A/c			13,75,500
(Various accounts representing capital and profit transferred to Equity Shareholders Account)			
Equity Shareholders A/c	Dr.	40,000	
To Underwriting Commission A/c			40,000
(Underwriting Commission A/c closed by transfer to Equity Shareholders A/c)			

10. On satisfaction of the claims of the equity shareholders, debit their account and credit whatever is given to them. Hence:

Equity Shareholders A/c	Dr.	13,35,500	
To Equity Shares in Wye Ltd.			11,20,000
To Cash A/c**			2,15,500

6. Entries in the books of Purchasing Company

1. Debit Business Purchase Account and Credit Liquidator of the vendor company with the account of the purchase consideration. Thus -

		₹	₹
Business Purchase A/c	Dr.	17,20,000	
To Liquidator of Zed Ltd.			17,20,000
(Amount payable to Zed Ltd. as per agreement dated....)			

2. (*i*) Debit assets acquired (except goodwill) at the value placed on them by the

---

*The Realisation Account will appear as follows :

Realisation Account

	₹		₹
To Sundry Assets	15,80,000	By Sundry Liabilities	3,25,000
To Cash (excess expenses of liquidation)	2,500	By Wye Ltd.	17,20,000
To Preference Shareholders	40,000		
To Equity Shareholders A/c - profit transferred	4,22,500		
	20,45,000		20,45,000

** The students should prepare Cash Account to ascertain the cash balance.

purchasing company;

(*ii*) Credit liabilities taken over at agreed values and credit Business Purchase Account with the amount of purchase consideration; and

(*iii*) Credit the account showing shares held in the company, if any, with the cost of such shares.

(*iv*) If the creditors as per (*ii*) and (*iii*) above exceed debits as per (*i*) above, the difference should be debited to Goodwill Account, in the reverse case, the difference should be credited to Capital Reserve.

Note : The amount of Goodwill or Capital Reserve that shall be included will be the amount as has been arrived at only in foregoing manner.

In the above case the entry to be passed shall be:

		₹	₹
Land and Building A/c	Dr.	5,50,000	
Plant and Machinery A/c	Dr.	6,50,000	
Patents A/c	Dr.	20,000	
Inventory A/c	Dr.	1,50,000	
Trade receivables	Dr.	1,80,000	
Goodwill	Dr.	5,05,000	
To			
Provision for Workmen's Compensation A/c			5,000
Trade payables			1,20,000
Debentures in Z Ltd.			2,10,000
Business Purchases Account			17,20,000
(Various assets and liabilities taken over from Zed Ltd. Goodwill ascertained as a balancing figure)			

3. On the payment to the vendor company the balance at its credit, the entry to be made by Wye Ltd. shall be:

		₹	₹
Liquidator of Zed Ltd.	Dr.	17,20,000	
To Cash			2,00,000
To 9% Preference Share Capital A/c			4,00,000
To Equity Share Capital A/c			8,00,000
To Securities Premium A/c			3,20,000
(Payment of cash and issue of shares in satisfaction of purchase consideration)			

4. Debentures in Z Ltd. A/c Dr. 2,10,000

To 7% Debentures A/c			2,00,000
To Premium on Debentures A/c			10,000

5. If the purchasing company is required to pay the expenses of liquidation of the vendor company, the amount should be debited to the Goodwill or Capital Reserve Account, as the case may be. In the instant case, the entry shall be:

Goodwill Account	Dr.	10,000	
To Cash Account			10,000
(Amount paid towards liquidation expenses on Zed Ltd.)			

Entries at par value - The students will note that purchasing company is left with a large debit in the Goodwill Account (Step No. 2) accompanied by quite a large amount in the Securities Premium Account (Step No. 3). The two cannot be adjusted. However, it would be permissible to negotiate on the basis to the market value of the shares but to make entries only on the basis of par of shares of purchasing company. This will mean that Goodwill Account (or Capital Reserve) will be automatically adjusted for the securities premium.

Inter Company-owing - Should the purchasing company owe an amount to the vendor company or *vice versa,* the amount will be included in the book debts of one company and trade payables of the other. This should be adjusted by the entry:

Trade payables	Dr.
To Trade receivables	

The entry should be made after the usual acquisition entries have been passed. At the time of preparing the Realisation Account and passing the business purchase entries, no attention need be paid to the fact that the two companies involved owed money mutually.

Adjustment of the value of stock - Inter-company owings arise usually from purchase and sale of goods; it is likely, therefore, that at the time, of the sale of business, the debtor company also has goods in stock which it purchased from the creditor company - the cost of the debtor company will include the profit made by the creditor company. After the takeover of the business it is essential that such a profit is eliminated. The entry for this will be made by the purchasing company. If it is the vendor company which has such goods in stock, at the time of passing the acquisition entries, the value of the stock should be reduced to its cost to the company which is acquiring the business; automatically goodwill or capital reserve, as the case may be, will be adjusted. But if the original sale was made by the vendor company and the stock is with the company acquiring the business, the latter company will have to debit Goodwill (or Capital Reserve) and credit stock with the amount of the profit included in the stock.

Illustration 6

The following draft Balance Sheets are given as on 31st March, 2014:

	(₹ in lakhs)			(₹ in lakhs)	
	Best Ltd.	Better Ltd.		Best Ltd.	Better Ltd.
	₹	₹		₹	₹
Share Capital:			*Fixed Assets*	25	15
Shares of ₹ 100, each			*Investments*	5	–
fully paid	20	10	*Current Assets*	20	5
Reserve and Surplus	10	8			
Other Liabilities	20	2			
	50	20		50	20

The following further information is given —

(a) *Better Limited issued bonus shares on 1st April, 2014, in the ratio of one share for every two held, out of Reserves and Surplus.*

(b) *It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.*

(c) *The value of shares in Best Ltd. was considered to be ₹ 150 and the shares in Better Ltd. were valued at ₹ 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.*

(d) *Liabilities of Better Ltd., included ₹ 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.*

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 2014 after the takeover.

Solution

LEDGER OF BETTER LIMITED

Fixed Assets Account

	₹		₹
To Balance b/d	15,00,000	By Realisation A/c (transfer)	15,00,000

Current Assets Account

	₹		₹
To Balance b/d	5,00,000	By Realisation A/c (transfer)	5,00,000

Liabilities Account

	₹		₹
To Realisation A/c	2,00,000	By Balance b/d	2,00,000

Realisation Account

	₹		₹
To Fixed Assets A/c	15,00,000	By Liabilities A/c	2,00,000
" Current Assets A/c	5,00,000	" Best Limited (Purchase Consideration)	15,00,000
		" Shareholders' A/c (Loss on Realisation)	3,00,000
	20,00,000		20,00,000

Share Capital Account

	₹		₹
To Sundry shareholders A/c - (transfer)	15,00,000	By Balance b/d	10,00,000
		" Reserves & Surplus A/c (Bonus issue)	5,00,000
	15,00,000		15,00,000

Reserves & Surplus Account

	₹		₹
To Share Capital (Bonus issue)	5,00,000	By Balance b/d	8,00,000
" Sundry Shareholders	3,00,000		
	8,00,000		8,00,000

Best Ltd.

	₹		₹
To Realisation A/c - Purchase Consideration	15,00,000	By Shares in Best Ltd	15,00,000
	15,00,000		15,00,000

Shares in Best Ltd.

	₹		₹
To Best Ltd.	15,00,000	By Sundry Shareholders A/c	15,00,000

Sundry Shareholders Account

	₹		₹
To Realisation A/c (Loss)	3,00,000	By Share Capital A/c	15,00,000
		” Reserves & Surplus A/c	3,00,000
” Share in Best Ltd.	15,00,000		
	18,00,000		18,00,000

Journal of Best Ltd.

2014			Dr. ₹	Cr. ₹
Apr. 1	Fixed Assets A/c	Dr.	15,00,000	
	Current Assets A/c	Dr.	5,00,000	
	To Liabilities A/c			2,00,000
	To Liquidator of Better Ltd.			15,00,000
	To Capital Reserve A/c			3,00,000
	(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of ₹ 15,00,000 as per agreement dated....)			
	Liquidator of Better Ltd.	Dr.	15,00,000	
	To Share Capital A/c			10,00,000
	To Securities Premium A/c			5,00,000
	(Discharge of Purchase consideration by the issue of equity shares of ₹ 10,00,000 at a premium of ₹ 50 per share as per agreement)			
	Trade payables A/c	Dr.	1,00,000	
	To Trade receivables A/c			1,00,000
	(Amount due from Better Ltd., and included in its creditors taken over, cancelled against own Trade receivables)			
	Capital Reserve A/c	Dr.	10,000	
	To Current Asset (Stock) A/c			10,000
	(Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account)			

Working Note :

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at ₹ 100 per share ₹ 15,00,000

Purchase consideration has been discharged by Best Ltd. by the issue of shares for ₹ 10,00,000 at a premium of ₹ 5,00,000. This gives the value of ₹ 150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
	b	Reserves and Surplus	2	17,90,000
2		**Current liabilities**		21,00,000
		Total		**68,90,000**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	3	40,00,000
	b	Non-current investments		5,00,000
2		**Current assets**		23,90,000
		Total		**68,90,000**

Notes to accounts

			₹
1	**Share Capital**		
	Equity share capital		
	Issued & Subscribed		
	30,000 shares of ₹ 100 (Of the above 10,000 shares have been issued for consideration other than cash)		30,00,000
	Total		**30,00,000**
2	**Reserves and Surplus**		
	Capital Reserve (3,00,000 – 10,000)		2,90,000
	Securities Premium		5,00,000
	Other reserves and surplus		10,00,000
	Total		**17,90,000**
3	**Tangible assets**		

Fixed Assets	25,00,000	
Acquired during the year	15,00,000	40,00,000
Total		**40,00,000**

Illustration 7

K Ltd. and L Ltd. amalgamate to form a new company LK Ltd. The financial position of these two companies on the date of amalgamation was as under:

	K Ltd. ₹	L Ltd. ₹		K Ltd. ₹	L Ltd. ₹
Share Capital			*Goodwill*	*80,000*	
Equity Shares			*Land & Building*	*4,50,000*	*3,00,000*
of ₹ 100 each	*8,00,000*	*3,00,000*	*Plant & Machinery*	*6,20,000*	*5,00,000*
7% Preference Share			*Furniture and*		
of ₹ 100 each	*4,00,000*	*3,00,000*	*Fittings*	*60,000*	*20,000*
5% Debentures	*2,00,000*	—	*Trade receivables*	*2,75,000*	*1,75,000*
General Reserve	—	*1,00,000*	*Stores & inventory*	*2,25,000*	*1,40,000*
Profit and Loss			*Cash at Bank*	*1,20,000*	*55,000*
Account	*3,71,375*	*97,175*	*Cash in hand*	*41,375*	*17,175*
Trade payables	*1,00,000*	*2,10,000*			
Secured Loan	—	*2,00,000*			
	18,71,375	*12,07,175*		*18,71,375*	*12,07,175*

The terms of amalgamation are as under:

(A) (1) The assumption of liabilities of both the Companies.

(2) Issue of 5 Preference shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at premium of ₹ 4 per share for each preference share held in both the Companies.

(3) Issue of 6 Equity shares of ₹ 20 each in LK Ltd. @ ₹ 18 paid up at a premium of ₹ 4 per share for each equity share held in both the Companies. In addition, necessary cash should be paid to the Equity Shareholders of both the Companies as is required to adjust the rights of shareholders of both the Companies in accordance with the intrinsic value of the shares of both the Companies.

(4) Issue of such amount of fully paid 6% debentures in LK Ltd. as is sufficient to discharge the 5% debentures in K Ltd. at a discount of 5% after takeover.

(B) (1) The assets and liabilities are to be taken at book values inventory and trade receivables for which provisions at 2% and 2 ½ % respectively to be raised.

(2) The trade receivables of K Ltd. include ₹ 20,000 due from L Ltd.

(C) The LK Ltd. is to issue 15,000 new equity shares of ₹ 20 each, ₹ 18 paid up at premium of ₹ 4 per share so as to have sufficient working capital. Prepare ledger accounts in the books of K Ltd. and L Ltd. to close their books.

Solution

Books of K Ltd.

Realisation Account

	₹		₹
To Goodwill	80,000	By 5% Debentures	2,00,000
To Land & Building	4,50,000	By Trade payables	1,00,000
To Plant & Machinery	6,20,000	By LK Ltd. (Purchase consideration)	15,60,000
To Furniture & Fitting	60,000		
To Trade receivables	2,75,000	By Equity shareholders A/c (loss)	51,375
To Stores & inventory	2,25,000		
To Cash at Bank	1,20,000		
To Cash in hand	41,375		
To Preference shareholders (excess payment)	40,000		
	19,11,375		19,11,375

Equity Shareholders Account

	₹		₹
To Realisation A/c (loss)	51,375	By Share capital	8,00,000
To Equity Shares in LK Ltd.	10,56,000	By Profit & Loss A/c	3,71,375
To Cash	64,000		
	11,71,375		11,71,375

7% Preference Shareholders Account

	₹		₹
To Preference Shares in LK Ltd.	4,40,000	By Share capital	4,00,000
		By Realisation A/c	40,000
	4,40,000		4,40,000

LK Ltd. Account

	₹			₹
To Realisation A/c	15,60,000	By Equity Shares in LK Ltd.		
		For Equity	10,56,000	
		Pref.	4,40,000	14,96,000
		By Cash		64,000
	15,60,000			15,60,000

Books of L Ltd.
Realisation Account

		₹			₹
To	Land & Building	3,00,000	By	Trade payables	2,10,000
To	Plant & Machinery	5,00,000	By	Secured loan	2,00,000
To	Furniture & Fittings	20,000	By	LK Ltd. (Purchase	
To	Trade receivables	1,75,000		consideration)	7,90,000
To	Inventory of stores	1,40,000	By	Equity shareholders A/c—	
To	Cash at bank	55,000		Loss	37,175
To	Cash in hand	17,175			
To	Pref. shareholders	30,000			
		12,37,175			12,37,175

Equity Shareholders Account

		₹			₹
To	Equity shares in LK Ltd.	3,96,000	By	Share Capital	3,00,000
To	Realisation	37,175	By	Profit & Loss A/c	97,175
To	Cash	64,000	By	Reserve	1,00,000
		4,97,175			4,97,175

7% Preference Shareholders Account

		₹			₹
To	Preference Shares in LK Ltd.	3,30,000	By	Share capital	3,00,000
			By	Realisation A/c	30,000
		3,30,000			3,30,000

LK Ltd. Account

		₹				₹
To	Realisation A/c	7,90,000	By	Equity shares in LK Ltd.		
				For Equity	3,96,000	
				Preference	3,30,000	7,26,000
			By	Cash		64,000
		7,90,000				7,90,000

Working Notes:

(i) Purchase consideration

	K Ltd. ₹	L Ltd. ₹
Payable to preference shareholders:		
Preference shares at ₹ 22 per share	4,40,000	3,30,000
Equity Shares at ₹ 22 per share	10,56,000	3,96,000
Cash [See W.N. (*ii*)]	64,000	64,000
	15,60,000	7,90,000

(ii) Value of Net Assets

		K Ltd. ₹		L Ltd. ₹
Goodwill		80,000		
Land & Building		4,50,000		3,00,000
Plant & Machinery		6,20,000		5,00,000
Furniture & Fittings		60,000		20,000
Trade receivables less 2.5%		2,68,125		1,70,625
Inventory less 2%		2,20,500		1,37,200
Cash at Bank		1,20,000		55,000
Cash in hand		41,375		17,175
		18,60,000		12,00,000
Less : Debentures	2,00,000		–	
Trade payables	1,00,000		2,10,000	
Secured Loans	–	(3,00,000)	2,00,000	(4,10,000)
		15,60,000		7,90,000
Payable in shares		14,96,000		7,26,000
Payable in cash		64,000		64,000

Illustration 8

The following are the summarized Balance Sheets of A Ltd. and B Ltd. as on 31.3.2014:

	(₹ in thousands)	
Liabilities	*A Ltd.*	*B Ltd.*
Share capital:		
Equity shares of 100 each fully paid up	*2,000*	*1,000*
Reserves	*800*	*---*
10% Debentures	*500*	*---*
Loans from Banks	*250*	*450*
Bank overdrafts	*---*	*50*

Trade payables	*300*	*300*
Proposed dividend	*200*	*---*
Total	*4,050*	*1,800*
Assets		
Tangible assets/fixed assets	*2,700*	*850*
Investments	*700*	*---*
Trade receivables	*400*	*150*
Cash at bank	*250*	*---*
Accumulated loss	*---*	*800*
Total	*4,050*	*1,800*

B Ltd. has acquired the business of A Ltd. The following scheme of merger was approved:

(i) Banks agreed to waive off the loan of ₹ 60 thousands of B Ltd.

(ii) B Ltd. will reduce its shares to ₹ 10 per share and then consolidate 10 such shares into one share of ₹ 100 each (new share).

(iii) Shareholders of A Ltd. will be given one share (new) of B Ltd. in exchange of every share held in A Ltd.

(iv) Proposed dividend of A Ltd. will be paid after merger to shareholders of A Ltd.

(v) Trade payables of B Ltd. includes ₹ 100 thousands payable to A Ltd.

Pass necessary entries in the books of B Ltd. and prepare Balance Sheet after merger.

Solution

Calculation of purchase consideration

One share of B Ltd. will be issued in exchange of every share of A Ltd. (i.e. 20,000 equity shares of B Ltd. will be issued against 20,000 equity shares of A Ltd.)	20,000 shares

Journal Entries in the books of B Ltd.

Date			*(₹ in thousands)*	
2014			*Dr.*	*Cr.*
March,31	Loan from bank A/c	Dr.	60	
	To Capital reduction A/c			60
	(Being loan from bank waived off to the extent of ₹ 60 thousand)			
	Equity share capital A/c (₹ 100)	Dr.	1,000	
	To Equity share capital A/c (₹ 10)			100

	To Capital reduction A/c			900
	(Being equity shares of ₹ 100 each reduced to ₹ 10 each)			
	Equity share capital A/c (₹ 10)	Dr.	100	
	To Equity share capital A/c (₹ 100 each)			100
	(Being 10 equity shares of ₹ 10 each consolidated to one share of ₹ 100 each)			
	Capital reduction A/c	Dr.	960	
	To Profit and loss A/c			800
	To Capital reserve A/c			160
	(Being accumulated losses set off against reconstruction A/c and balance transferred to capital reserve account)			
	Business purchase A/c	Dr.	2,000	
	To Liquidator of A Ltd.			2,000
	(Being purchase of business of A Ltd.)			
	Fixed asset A/c	Dr.	2,700	
	Investment A/c	Dr.	700	
	Trade receivables A/c	Dr.	400	
	Cash at bank A/c	Dr.	250	
	To Trade payables A/c			300
	To Proposed dividend A/c			200
	To Loans from bank A/c			250
	To 10% Debentures A/c			500
	To Business purchase A/c			2,000
	To Reserves A/c			800
	(Being assets, liabilities and reserves taken over under pooling of interest method)			
	Liquidator of A Ltd. A/c	Dr.	2,000	
	To Equity share capital A/c			2,000
	(Being payment made to liquidators of A Ltd. by allotment of 20,000 new equity shares)			
	Trade payables A/c	Dr.	100	
	To Trade receivables A/c			100
	(Being mutual owing cancelled)			
	Proposed dividend A/c	Dr.	200	

	To Bank A/c (Being dividend paid off)		200

Balance Sheet of B Ltd. after merger as on 31.3.2014

		Particulars	Notes	₹ in '000
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	2,100
	b	Reserves and Surplus	2	960
2		**Non-current liabilities**		
	a	Long term borrowings	3	1,140
3		**Current liabilities**		
	a	Trade payables		500
	b	Short term borrowings	4	50
		Total		**4,750**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets		3,550
	b	Non-current investments		700
2		**Current assets**		
	a	Trade receivables		450
	b	Cash and cash equivalents		50
		Total		**4,750**

Notes to accounts

			₹ in '000
1	**Share Capital**		
	21,000, Equity shares of ₹ 100 each fully paid		2,100
	(Out of the above, 20,000 shares have been issued for consideration other than cash)		
2	**Reserves and Surplus**		
	Capital reserve	160	
	General reserve	800	
	Total		**960**

3	**Long Term Borrowings**		
	10% Debentures	500	
	Loan from Bank (250+450-60)	640	1,140
4	**Short term borrowings**		
	Bank overdraft		50

Illustration 9

The following are the summarized Balance Sheets of P Ltd. and Q Ltd. as on 31st March, 2014:

Liabilities	*P Ltd. ₹*	*Q Ltd. ₹*	*Assets*	*P Ltd. ₹*	*Q Ltd. ₹*
Share Capital			*Fixed Assets*	*7,00,000*	*2,50,000*
Equity Shares of ₹ 10 each	*6,00,000*	*3,00,000*	*Investment*	*80,000*	*80,000*
			Current Assets:		
10% Pref. Shares of ` 100 each	*2,00,000*	*1,00,000*	*Inventory*	*2,40,000*	*3,20,000*
			Trade receivables	*4,20,000*	*2,10,000*
Reserves and Surplus	*3,00,000*	*2,00,000*	*Cash at Bank*	*1,10,000*	*40,000*
Secured Loans:					
12% Debentures	*2,00,000*	*1,50,000*			
Current Liabilities:					
Trade payables	*2,50,000*	*1,50,000*			
	15,50,000	*9,00,000*		*15,50,000*	*9,00,000*

Details of Trade receivables and trade payables are as under:

	P Ltd. (₹)	*Q Ltd. (₹)*
Trade receivables		
Debtors	*3,60,000*	*1,90,000*
Bills Receivable	*60,000*	*20,000*
	4,20,000	*2,10,000*
Trade payables		
Sundry Creditors	*2,20,000*	*1,25,000*
Bills Payable	*30,000*	*25,000*
	2,50,000	*1,50,000*

Fixed Assets of both the companies are to be revalued at 15% above book value. Inventory in Trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, P Ltd. will absorb Q Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by P Ltd. at par against 6 shares of Q Ltd.

(ii) 10% Preference Shareholders of Q Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in P Ltd.

(iii) 12% Debentureholders of Q Ltd. are to be paid at 8% premium by 12% Debentures in P Ltd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by P Ltd. to Q Ltd. for Liquidation expenses. Sundry Creditors of Q Ltd. include ₹ 10,000 due to P Ltd.

Prepare:

(a) Journal entries in the books of P Ltd.

(b) Statement of consideration payable by P Ltd.

Solution

(a) Journal Entries in the Books of P Ltd.

		Dr. ₹	*Cr.* ₹
Fixed Assets	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of fixed assets at 15% above book value)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @ 10%)			
Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	4,90,000	
To Liquidator of Q Ltd.			4,90,000
(Consideration payable for the business taken over from Q Ltd.)			
Fixed Assets (115% of ₹ 2,50,000)	Dr.	2,87,500	

Inventory (95% of ₹ 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	20,000	
Investment	Dr.	80,000	
Cash at Bank	Dr.	10,000	
(₹ 40,000 –₹ 30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in Q Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			4,90,000
To Capital Reserve (Balancing figure)			80,000
(Incorporation of various assets and liabilities taken over from Q Ltd. at agreed values and difference of net assets and purchase consideration being credited to capital reserve)			
Liquidator of Q Ltd.	Dr.	4,90,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
(Discharge of consideration for Q Ltd.'s business)			
12% Debentures in Q Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders of Q Ltd. at a discount of 10%)			
Sundry Creditors	Dr.	10,000	
To Sundry Debtors			10,000
(Cancellation of mutual owing)			
Goodwill	Dr.	30,000	
To Bank			30,000
(Being liquidation expenses reimbursed to Q Ltd.)			
Capital Reserve	Dr.	30,000	
To Goodwill			30,00
(Being goodwill set off)			

(b) Statement of Consideration payable by P Ltd. for 30,000 shares (payment method)

Shares to be allotted $\frac{30,000}{6} \times 8$ = 40,000 shares of P Ltd.

Issued 40,000 shares of ₹ 10 each i.e. ₹ 4,00,000 (i)

For 10% preference shares, to be paid at 10% discount

₹ $\frac{1,00,000 \times 90}{100}$ ₹ 90,000 (ii)

Consideration amount [(i) + (ii)] ₹ 4,90,000

Illustration 10

Given below are the summarized balance sheets of Huge Ltd and Big Ltd. as on 31.12.2013. Big Ltd. was merged with Huge Ltd. with effect from 1.1.2014.

Balance Sheets as on 31.12.2013

(₹)

Liabilities	*Huge Ltd.*	*Big Ltd.*	*Assets*	*Huge Ltd.*	*Big Ltd.*
Share capital :			*Sundry fixed assets*	*9,50,000*	*4,00,000*
Equity shares of ₹ 10 each	*7,00,000*	*2,50,000*	*Investments (Non-trade)*	*2,00,000*	*50,000*
General reserve	*3,50,000*	*1,20,000*	*Inventory*	*1,20,000*	*50,000*
Profit and loss A/c	*2,00,000*	*65,000*	*Trade receivables*	*75,000*	*80,000*
Export profit reserve	*70,000*	*40,000*	*Advance tax*	*80,000*	*20,000*
12% Debentures	*1,00,000*	*1,00,000*	*Cash and bank*	*2,75,000*	*1,30,000*
Trade payables	*40,000*	*45,000*			
Provision for taxation	*1,00,000*	*60,000*			
Proposed Dividend	*1,40,000*	*50,000*			
	17,00,000	*7,30,000*		*17,00,000*	*7,30,000*

Huge Ltd. would issue 12% debentures to discharge the claims of the debenture holders of Big Ltd. at par. Non-trade investments of Huge Ltd. fetched @ 25% while those of Big Ltd. fetched @ 18%.

Profit of Huge Ltd. and Big Ltd. during 2011 2012 and 2013 were as follows:

Year	*Huge Ltd.* ₹	*Big Ltd.* ₹
2011	*5,00,000*	*1,50,000*
2012	*6,50,000*	*2,10,000*
2013	*5,75,000*	*1,80,000*

Goodwill may be calculated on the basis of capitalization method taking 20% as the normal rate of return. Purchase consideration is discharged by Huge Ltd. on the basis of intrinsic value per share. Both companies decided to cancel the proposed dividend as it has already been not approved by Board of Directors.

Pass Journal Entries and prepare the balance sheet of Huge Ltd. after the merger.

Solution

Balance Sheet of M/s. Huge Ltd. after merger

		Particulars	Notes	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	9,24,000
	b	Reserves and Surplus	2	14,80,960
2		**Non-current liabilities**		
	a	Long term borrowings	3	2,00,000
3		**Current liabilities**		
	a	Trade payables		85,000
	b	Short term provisions	4	1,60,000
		Total		**28,49,960**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets		13,50,000
		Intangible assets	5	3,80,000
	b	Non-current investments		2,50,000
	c	Other non-current assets	7	40,000
2		**Current assets**		
	a	Inventories		1,70,000

	b	Trade receivables		1,55,000
	c	Cash and cash equivalents		4,04,960
	d	Short term loans and advances	6	1,00,000
		Total		**28,49,960**

Notes to accounts

				₹
1	**Share Capital**			
	92,400 Equity shares of ₹ 10 each			9,24,000
	(of which 22,400 shares were issued for consideration other than cash)			
2	**Reserves and Surplus**			
	Securities premium			6,80,960
	General reserve			3,50,000
	Profit and loss A/c		2,00,000	
	Add: Proposed dividend Cancelled		1,40,000	3,40,000
	Export profit reserve (70,000 + 40,000)			1,10,000
		Total		14,80,960
3	**Long Term Borrowings**			
	Secured			
	12% Debentures (1,00,000+1,00,000)			2,00,000
4	**Short term provisions**			
	Provision for tax (1,00,000+60,000)			1,60,000
5	**Intangible assets**			
	Goodwill (W.N.3C)			3,80,000
6	**Short term loans and advances**			
	Advance tax (80,000+20,000)			1,00,000
7	**Other non-current asset**			
	Amalgamation Adjustment A/c			40,000

Working Notes:

1. **Calculation of purchase consideration:**

Equity shares of Big Ltd.	25,000 shares
Intrinsic value per share of Big Ltd. (W.N.2)	₹ 36.2

Value of shares ₹ 9,05,000

Intrinsic value per share of Huge Ltd. (W.N.2) ₹ 40.4

No. of shares to be issued by Huge Ltd. ₹ 9,05,000/₹ 40.4 = 22,400.99 shares

i.e 22,400 shares and cash for fraction i.e. 0.99 x ₹ 40.4= ₹ 40

Purchase consideration

i.	22,400 shares @ ₹ 40.4			
	Capital [₹ 10 per Share]	2,24,000		
	Premium [₹ 30.4 per Share]	6,80,960	₹	9,04,960
ii.	Cash for fraction		₹	40
iii.	Total purchase consideration payable		₹	9,05,000

2. Intrinsic value per share:

	Huge Ltd.		Big Ltd	
	₹	₹	₹	₹
Assets				
i. Goodwill (W.N.3)	13,65,000		3,80,000	
ii. Sundry fixed assets	9,50,000		4,00,000	
iii. Investments	2,00,000		50,000	
iv. Inventory	1,20,000		50,000	
v. Trade receivables	75,000		80,000	
vi. Advance tax	80,000		20,000	
vii. Cash and bank balance	2,75,000	30,65,000	1,30,000	11,10,000
Liabilities				
i. 12% Debentures	1,00,000		1,00,000	
ii. Trade payables	40,000		45,000	
iii. Provision for tax	1,00,000	(2,40,000)	60,000	(2,05,000)
Net assets		28,25,000		9,05,000
No. of shares		70,000		25,000
Intrinsic value per share (upto one decimal)		40.4		36.2

3. Valuation of goodwill

A. Capital Employed

	Huge Ltd.		Big Ltd.	
	₹	₹	₹	₹
Assets				
i. Sundry fixed assets	9,50,000		4,00,000	

ii. Investment (Non-trade)	-		-	
iii. Inventory	1,20,000		50,000	
iv. Trade receivables	75,000		80,000	
v. Advance tax	80,000		20,000	
vi. Cash and bank balance	2,75,000	15,00,000	1,30,000	6,80,000
Liabilities:				
i. 12% Debentures	1,00,000		1,00,000	
ii. Trade payables	40,000		45,000	
iii. Provision for tax	1,00,000	(2,40,000)	60,000	(2,05,000)
Capital employed		12,60,000		4,75,000

B. Average pre-tax profit:

Particulars	Huge Ltd. ₹	Big Ltd. ₹
2011	5,00,000	1,50,000
2012	6,50,000	2,10,000
2013	5,75,000	1,80,000
Total (a+b+c)	17,25,000	5,40,000
Simple Average [total ÷3]	5,75,000	1,80,000
Less: Non-trading income		
(2,00,000 @ 25%)	(50,000)	
(50,000 @ 18%)		(9,000)
Average profit	5,25,000	1,71,000

C. Computation of goodwill: ₹

Particulars	Huge Ltd.	Big Ltd.
Capitalised value of average profits $\left[\frac{5,25,000}{.20};\frac{1,71,000}{.20}\right]$	26,25,000	8,55,000
Capital employed	12,60,000	4,75,000
Goodwill	13,65,000	3,80,000

Summary

1. Amalgamation means joining of two or more existing companies into one company, the joined companies lose their identity and form themselves into a new company.

2. In absorption, an existing company takes over the business of another existing company. Thus there is only one liquidation and that is of the merged company.

3. A company which is merged into another company is called a transferor company or a vendor company.

4. A company into which the vendor company is merged is called transferee company or vendee company or purchasing company.

5 In amalgamation in the nature of merger there is genuine pooling of:

   a) Assets and liabilities of the amalgamating companies,

   b) Shareholders' interest,

   Also the business of the transferor company is intended to be carried on by the transferee company.

6. In amalgamation in the nature of purchase, one company acquires the business of another company.

7. Purchase Consideration can be defined as the aggregate of the shares and securities issued and the payment made in form of cash or other assets by the transferee company to the share holders of the transferor company.

8. There are two main methods of accounting for amalgamation:

   a) The pooling of interests method, and

   b) The purchase method.

9. Under pooling of interests method, the assets, liabilities and reserves of the transferor company will be taken over by transferee company at existing carrying amounts.

10. Under purchase method, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or the purchase consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation